

BEFORE THE
SURFACE TRANSPORTATION BOARD

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Docket No. EP 766

JOINT PETITION FOR RULEMAKING – ANNUAL REVENUE ADEQUACY DETERMINATIONS

INDUSTRIAL MINERALS ASSOCIATION – NORTH AMERICA COMMENTS

Industrial Minerals Association – North America (“IMA”) respectfully submits its comments in the above-captioned proceeding in accordance with the February 4, 2021 decision by the Surface Transportation Board (“STB” or “Board”). IMA strongly opposes the proposal to fundamentally change the process to determine annual revenue adequacy.

THE PROPOSED RULEMAKING

On September 1, 2020, Union Pacific Railroad Company (“UP”), Norfolk Southern Railway Company (“NS”), and the U.S. rail operating affiliates of Canadian National Railway Company (“CN”) (collectively, “Joint Carriers”) filed a joint petition for rulemaking to change the Board’s procedures for determining which Class I rail carriers are earning adequate revenues under 49 U.S.C. § 10704(a)(3).

The Board annually determines each Class I railroad's revenue adequacy, most recently in *Railroad Revenue Adequacy— 2019 Determination*, EP 552 (Sub-No. 24) (STB served Oct. 1, 2020). In that decision, the Board found five carriers (BNSF Railway Company ("BNSF"), CSX Transportation, Inc. ("CSXT"), NS, Soo Line Corporation ("CP"), and UP) revenue adequate in 2019. *R.R. Revenue Adequacy— 2019 Determination*, EP 552 (Sub-No. 24), slip op. at 2. Under the Board's procedures, "a railroad is considered revenue adequate under 49 U.S.C. § 10704(a) if it achieves a rate of return on net investment ("ROI") equal to at least the current cost of capital for the railroad industry." *Id.* at 1.

The Joint Carriers propose two changes to the Board's procedures for annually determining revenue adequacy. First, the Joint Carriers propose that the Board determine whether a railroad is revenue adequate by comparing the extent by which its ROI exceeds the rail industry's cost of capital to the extent by which companies in the S&P 500 exceed their cost of capital—in short, to examine railroads in comparison with the larger universe of S&P 500 companies ("the Comparison Proposal"). (Pet. 3, 8.) The Joint Carriers contend that railroads compete against other firms for capital, and that the financial health of the railroad industry "must be considered in relation to the competition railroads face in the capital markets from other, unregulated firms." (*Id.* at 3.) More specifically, the Joint Carriers argue that the Board should define annual revenue adequacy to mean that a railroad's "Adjusted STB ROI" exceeds the rail industry cost of capital by more than the median S&P 500 firm's ROI exceeds its cost of capital. (*Id.* at 20-21.) Under the Comparison Proposal, the Board would direct the Association of American Railroads to submit "Adjusted STB ROI" and cost of capital calculations for every S&P 500 company, and the Board "would calculate the median difference between the

Adjusted STB ROI and the cost of capital for all companies in the S&P 500, except for banking and real estate companies.” (*Id.* at 21.) As part of the Comparison Proposal, the Joint Carriers also propose including non-goodwill intangible assets in the railroads’ and S&P 500 companies’ asset bases. (*Id.* at 35.)

The second proposal from the Joint Carriers is that the Board change how it treats deferred taxes in the revenue adequacy determination (“the Deferred Taxes Proposal”). Rather than the Board’s current “utility method,” which removes annual deferred taxes from net operating income and removes accumulated deferred taxes from a company’s investment base, the Joint Carriers propose a flow-through approach, under which annual deferred taxes and accumulated deferred taxes would not be removed from net operating income and the investment base, respectively. (*Id.* at 38.) The Joint Carriers state that the practical effect would be “an annual measurement that is on a cash basis, where the impact of any deferred taxes is captured by the measurement of financial health if and when those taxes come due.” (*Id.* at 38-39.)

On September 21, 2020, the Board received three replies to the petition, one each from CSXT, the Western Coal Traffic League (“WCTL”), and a group of several shippers (“Joint Shippers”). CSXT supports the petition, while WCTL and the Joint Shippers oppose it.

WCTL argues that the petition misrepresents the role of revenue adequacy and is an attempt by the Joint Carriers to avoid being found revenue adequate and thus potentially subject to the revenue adequacy rate constraint. (WCTL Reply 4-5.) Regarding the Comparison Proposal, WCTL asserts that many S&P 500 firms have different capital structures than railroads

and hundreds are not capital intensive. (*Id.* at 12.) WCTL also argues that the Comparison Proposal would result in revenue adequacy determinations at odds with the investment community's perception of railroads' financial health. (*Id.* at 13 (citing Joint Opening Comments of WCTL 11-12, Sept. 5, 2014, *R.R. Revenue Adequacy*, EP 722).) Regarding the Deferred Taxes Proposal, WCTL argues that the flow-through approach ignores tax deferrals and the fact that railroads pay taxes below the corporate rate. (*Id.* at 14-16.) WCTL also questions the relevance and accuracy of the Joint Carriers' examples of the utility and flow-through methods. (*Id.* at 17.)

The Joint Shippers argue that the Comparison Proposal would "render all Class I railroads revenue-inadequate and likely maintain that status for decades to come." (Joint Shippers Reply 4.) They contend that the current annual revenue-adequacy determination already sets a conservatively high bar (*id.* at 4-8) and assert that the Joint Carriers' rationales for the Comparison Proposal do not actually support the proposal, (*id.* at 11-12 (stating that the Joint Carriers' arguments "assume a role for revenue adequacy as a measure of market power, competitive failure and monopoly profits that Congress never intended"))).

On October 13, 2020, the Joint Carriers filed a motion for leave to respond to the reply comments, along with a response addressing WCTL's and the Joint Shippers' arguments against both proposals.

The Board opened a rulemaking proceeding to further consider the Joint Carriers' petition and the issues that it raises. The Board invited comment on the issues raised in the petition generally as well as on specific questions.

COMMENTS

In Section 205 of the Railroad Revitalization and Regulatory Reform Act of 1976, Pub. L. No. 94-210, 90 Stat. 127, Congress mandated that the Board's predecessor, the Interstate Commerce Commission ("ICC"), promulgate—and thereafter revise and maintain—standards and procedures for establishing railroad revenue adequacy. Four years later, in the Staggers Rail Act of 1980 ("Staggers"), Pub. L. 96-448, 94 Stat. 1895, the agency's rail transportation policy was revised to include, among other things, "promot[ing] a safe and efficient rail transportation system by allowing rail carriers to earn adequate revenues, as determined by the [agency]." Additionally, Section 205 of Staggers required the ICC to begin determining annually "which rail carriers are earning adequate revenues." To implement this requirement, the ICC began a proceeding to adopt standards for determining railroad revenue adequacy. In that proceeding, the ICC concluded that "the only revenue adequacy standard consistent with the requirements of [Staggers] is one that uses a rate of return equal to the cost of capital." *Standards for R.R. Revenue Adequacy*, 364 I.C.C. 803, 811 (1981), *aff'd sub nom. Bessemer & Lake Erie R.R. v. ICC*, 691 F.2d 1104 (3d Cir. 1982).

These statutory requirements, now codified at 49 U.S.C. § 10704(a)(2) and (3), still govern, and the Board (like the ICC before it) annually determines which rail carriers are revenue adequate by comparing a carrier's rate of return with the cost of capital. Since the issuance of Standards for Railroad Revenue Adequacy in 1981, adjustments have been made to the agency's methodology in order to improve the agency's ability to determine accurately revenue adequacy. *See, e.g., Use of a Multi-Stage Discounted Cash Flow Model in Determining the R.R. Industry's Cost of Capital*, EP 664 (Sub-No. 1) (STB served Jan. 28, 2009); *R.R. Revenue*

Adequacy—1988 Determination, 6 I.C.C.2d 933 (1990), *aff'd sub nom. Ass'n of Amer. R.Rs. v. ICC*, 978 F.2d 737 (D.C. Cir. 1992); *Supplemental Reporting of Consol. Info. for Revenue Adequacy Purposes*, 5 I.C.C.2d 65 (1988); *Standards for R.R. Revenue Adequacy*, 3 I.C.C.2d 261 (1986), *aff'd sub nom. Consol. Rail Corp. v. United States*, 855 F.2d 78 (3d Cir. 1988). However, none of these changes have fundamentally changed the STB's methodology like the ones proposed herein.

Why These Proposed Changes Are Unwarranted.

After the enactment of Staggers, the railroad industry underwent a complete financial turnaround. Due to these deregulatory changes by Congress, the rail industry has blossomed and become one of the darlings of Wall Street. Railroads were able to shed unprofitable rail lines through a more liberal abandonment process. Rail mergers became commonplace and resulted in the consolidation of the rail industry from 40 railroads in 1980 to 7 by the late 1990s. The number of employees that worked for the railroads decreased significantly. Moreover, railroads began to attract more freight traffic because of their ability to set more competitive prices.

In a study authorized by Congress, the Transportation Research Board discussed these annual revenue adequacy calculations at length, specifically noting as follows:

Like ICC, STB is required to make annual determinations of each Class I railroad's revenue adequacy. For most of its first 10 years, STB determined that all railroads were falling short of revenue adequacy according to its industrywide average cost of capital measure. Railroads viewed these findings as indicative of a continued need to limit

regulatory intervention and particularly to proceed cautiously in changing the standards used for adjudicating rate protests. Meanwhile, shippers have claimed that the method used to judge revenue adequacy does not reflect the reality of railroads having obvious access to credit markets and have identified other indicators of railroad profitability such as positive balance sheets and rising stock values.

Having long been critical of STB's annual findings of most railroads falling short of revenue adequacy, some shippers now commend the results as more railroads have been declared revenue adequate during the past 5 years. In response, shipper groups have asked STB to reexamine how it uses the revenue adequacy results. They contend that the new findings of railroad profitability are relevant to the law's stated policy "to maintain reasonable rates where there is an absence of effective competition and where rail rates provide revenues which exceed the amount necessary to maintain the rail system and to attract capital." Some would like to see STB expand access to rate relief by taking a less cautious approach to safeguarding railroad revenue adequacy and profits.

National Academies of Sciences, Engineering, and Medicine 2015, *Modernizing Freight Rail Regulation*, pp. 38-39 (citations omitted).

As the railroads have been declared revenue adequate more and more often in recent years,¹ the Joint Carriers now come before the STB seeking fundamental changes to the

¹ Over the most recent 11 years of the Board's annual revenue-adequacy determinations (2009- 2019), UP was revenue-adequate for the last 10 years straight, BNSF and NS for 9 of those years, CP over 6 of the most recent 7 years, CN for 3 years, and CSX just in the two most

dynamics of this test. It is clear this proposal is being sought to ensure that these more recent findings of annual revenue adequacy cannot be obtained in the decades to come despite the rail industry's great economic success over the past several decades.

The intent of this proposal is clear – it would eliminate the possibility to use the revenue adequacy constraint as a tool for rate relief as discussed at the STB December 2019 revenue adequacy hearing. The STB's recent exploration of the use of revenue adequacy constraint as a method for rate review and the timing of this petition cannot be viewed as a mere coincidence. It is evident that these railroads seek to stop the use of this long-accepted rate case concept by placing revenue adequacy outside the reach of any Class I railroad. This evident ploy cannot be permitted here.

The only people who claim the railroads are not revenue adequate at this point are the railroads themselves. All other analysts of this industry view Class I railroads as financially viable. "Railroads long ago attained financial viability and independence from government subsidies." Modernizing Freight Rail Regulation at p. 155. The evidence is overwhelming that Class I railroads are revenue adequate, yet here we are examining a proposal that would contradict this clear truth. The Board should not permit this inequitable result to occur.

Conclusion

Based on the foregoing discussion, IMA respectfully asks the STB to reject the petition to change the procedures for determining revenue adequacy. Instead, IMA urges the STB to

recent years. Worthy of special mention, NS has been revenue-adequate for 12 of the past 16 years. See <https://prod.stb.gov/reports-data/economic-data/>.

continue where it left off in 2019 to propose a methodology for the use of the revenue adequacy constraint in the interest of providing rail shippers a viable tool to challenge unreasonable rates.

Respectfully submitted,

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